



DEPARTMENT OF AGRICULTURE

Rural Housing Service

7 CFR Part 3560

[Docket No. RHS-21-MFH-0026]

RIN 0575-AD17

Multi-Family Housing (MFH) Direct Loan Programs

AGENCY: Rural Housing Service, USDA.

ACTION: Final rule.

SUMMARY: The Rural Housing Service (RHS or Agency), an agency in the United States Department of Agriculture (USDA) Rural Development Mission area, published a proposed rule in the **Federal Register** on September 23, 2020, to amend its regulations for the Multi-Family Housing Direct Loans and Grants Programs to implement changes related to the development of a sustainable plan for the Rental Assistance (RA) program. Through this action, RHS is adopting the changes as proposed. The regulation updates are intended to provide additional RA program flexibility and transparency, and to improve the efficiency of managing assets in the Direct Loan portfolio.

DATES: The final rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Jennifer Larson, Multi-Family Housing Asset Management Division, Rural Housing Service, Stop 0782, 1400 Independence Avenue SW, Washington DC 20250-0782. Telephone 202-720-1615.

SUPPLEMENTARY INFORMATION:

I. Background Information

Rural Development (RD) is a mission area within the United States Department of Agriculture (USDA) comprised of the Rural Utilities Service (RUS), Rural Housing Service (RHS) and Rural Business-Cooperative Service (RBCS). RD's mission is to increase economic opportunity and improve the quality of life for all rural Americans. RD meets its mission by providing loans, loan guarantees, grants, and technical assistance through more than 40 programs aimed at creating and improving housing, businesses, and infrastructure throughout rural America. We help rural residents buy or rent safe, affordable housing and make health and safety repairs to their homes.

The RHS Multi-Family Housing (MFH) programs, provide affordable multi-family rental housing in rural areas by financing projects geared for low-income, elderly and disabled individuals and families as well as domestic farm laborers. MFH Programs extends its reach by guaranteeing loans for affordable rental housing designed for low to moderate-income residents in rural areas and towns. MFH Programs are administered, subject to appropriations, by the USDA as authorized under Sections 514, 515 and, 516 and 521 of the Housing Act of 1949, as amended. The Agency operates a multifamily rural rental housing direct loan program under section 515 for off-farm labor housing and section 514 for farm labor housing. The Agency also provides grants under the section 516 farm labor housing program and section 521 provides project-based rental assistance payments to property owners.

The RHS published a proposed rule on September 23, 2020 (85 FR 59682) to: (1) implement programmatic changes related to development of a “sustainability plan” for the Rental Assistance (RA) Program, including new Agency flexibilities in managing the RA distribution; (2) integrate new asset management policies; and (3) incorporate technical corrections to clarify

reference and formatting issues in the regulation. The purpose of this action is to finalize these provisions as proposed in the proposed rule on September 23, 2020.

RHS published an interim rule on November 26, 2004 (69 FR 69032), with an effective date of 2/24/2005. On February 22, 2005, a delay of effective date was published in the Federal Register (70 FR 8503) to indefinitely delay the following sections: 3560.152(a)(1), 3560.154(a)(7), 3560.156(c)(12), and 3560.254(c)(3). The delay of effective date remains in effect for these sections until a future final rule is published to lift the stay.

II. Comments and Responses

The 60-day comment period for the proposed rule ended on November 23, 2020. A total of 16 comments were received. Commenters included non-profit housing organizations or associations representing housing providers and private citizens.

The following actions in the proposed rule will be included in the final rule with full consideration of public comments, included below, with the Agency's responses.

Issue 1: A Commenter pointed to include change to § 3560.72 to consistently use "Leadership Designee," instead of MFH Leadership Designee. As noted in the proposed rule, page 59684, the Agency's intent is to change State Director to Leadership Designee to allow flexibility for future staff. The commenter supported not limiting the change to only "MFH Leadership Designee," for even greater flexibility.

Agency Response 1: The Agency acknowledges the commenter's support for this modification. The Agency agrees, as the commenter stated, that the language under § 3560.72 should be amended by removing the words 'State Director' and adding in their place 'Leadership Designee' in the second sentence of paragraph (b).

Issue 2: Several commenters requested more contact information about the Leadership Designee positions throughout the Agency.

Agency Response 2: The Agency has established a list of Field Operations servicing officials for all projects available on the public Rural Development website with email contact information provided for each team member. The Regional Director for each region is also provided on the public Rural Development website.

Issue 3: Several commenters requested more detail on the MFH program eligibility requirements regarding domestic farm laborers. This included persons legally admitted on a temporary or permanent basis, including the U.S. Citizenship and Immigration Services (USCIS) H2A Program for Temporary Agricultural Workers.

Agency Response 3: The proposed “Domestic Farm Laborer” definition reflects the Agency’s compliance with the statutory requirements of the Consolidated Appropriations Act of 2018, permanently amending Section 514(f)(3)(A) of the Housing Act of 1949 (42 U.S.C. 1484(f)(3)(A)). The Agency believes that additional clarification is not required.

Issue 4: One commenter expressed concern that clarification regarding the Agency’s authority to establish agency-held escrows in the proposed rule did not include an explanation as to why this authority is needed and did not place any conditions on the Agency’s exercise of this authority. The commenter urged the Agency to remove this provision without an explanation of the need and establish standards for when this requirement can be imposed on a borrower.

Agency’s Response 4: The proposed rule clarified that in §3560.65, the authorization of an agency-held escrow account only applies to the Reserve Account. “The Agency may establish an escrow account for the collection and disbursement of reserve account funds.” This authority was historically included in the loan documents but was not addressed in the regulation. This provision was prompted by MFH borrowers that had identified Supervised Bank Account requirements in RD’s regulations, which made it difficult to obtain these accounts with commercial banks. This amendment will allow the Agency, if needed, to establish an escrow

reserve account to collect and disperse an MFH project's funds. The Agency finds that no change to the proposed regulatory language is needed.

Issue 5: Several commenters concurred that self-managed properties must also sign the Management Certification. Two commenters requested that additional tasks be mentioned as a project expense or an add-on fee to the management fee if required of the management agent. They also requested that outside payroll companies used to pay on-site staff, be an allowable expense to the property.

Agency's Response 5: The Agency finds that no change is required to the proposed rule language. The rule expands the language at §3560.102(b) to clarify that performance assessments of management agents will be used when determining the allowable management fee, and that the management plan should describe whether administrative expenses are to be paid from management agent fees or project operations, including a task list of charges covered by the fee.

Issue 6: One commenter noted the Affirmative Fair Housing Marketing Plan (AFHMP) change in minimum required rental units to prepare and maintain an AFHMP increased from 4 to 5 units, and requested details on how many projects, would be affected by this change. This update allows the Agency to align with the Affirmative Fair Housing Marketing Plan (AFHMP) as defined in 24 CFR part 200, subpart M. Borrowers must comply with the requirements of the Fair Housing Amendments Act of 1988, and this section to meet their fair housing responsibilities.

Agency's Response 6: Currently, there are 95 4-unit Rural Rental Housing and Farm Labor Housing properties in the Multi-Family Housing portfolio. These properties will no longer be required to maintain an AFHMP.

Issue 7: Three commenters included praise for the proposed rule's changes to management flexibilities that would provide a more streamlined process by which RA funds can be made available. The commenters did not request any changes to the rule.

Agency's Response 7: The Agency acknowledges the commenters support.

Issue 8: One commenter requested that there first be notice and opportunity to resolve a late tenant certification submission to the Agency, so that the owner and manager can resolve the matter amongst themselves. The commenter did not approve of requiring the owner to pay overage, *i.e.*, to pay for a paperwork delay.

Agency's Response 8: The parameters established for timely tenant certification submission are beyond the scope of the proposed rule. The Agency notes that the timely submission of tenant certifications is a basic responsibility of the borrower/management agent under the MFH program's existing Loan Documents requirements. The proposed language clarifies that the borrower may lose RA as well. No change to the language is needed.

Issue 9: Two commenters expressed concern regarding the admission of persons with criminal histories. They pointed to the regulations not specifying whether a disqualification is only authorized when there was a conviction or if a mere arrest is sufficient. Additional concern regarded the privacy implications of checks on criminal history.

Agency's Response 9: The Agency finds that the proposed change has no impact on allowing exceptions for denial under the U.S. Department Housing and Urban Development (HUD) regulations in 24 CFR 5.854, 5.855, 5.856, 5.857. This also allows a time frame of 3 years from conviction. The Borrower must establish their own standards that prohibit admission of applicants with a criminal history, based on their determination of reasonable cause. This qualifies the individualized assessment requirement of an applicant's criminal background as per HUD's Office of General Counsel Guidance on Application of Fair Housing Act Standards to the Use of Criminal Records by Providers of Housing and Real Estate-Related Transactions issued on April 4, 2016, and the Fair Housing Act, 42 U.S.C. Sections 3601-19.

Issue 10: Several commenters requested that the Agency cross-reference the existing HUD Violence Against Women Act (VAWA) regulations or amend MFH program requirements

in the lease requirement section so that owners and residents know what their respective rights and responsibilities are, including notices of VAWA rights, documentation, confidentiality, evictions, and transfers.

Agency Response 10: The Agency is working to update guidance on VAWA and will take recommendations into consideration. Additional changes may be included at that time.

Issue 11: Three of the commenters questioned whether there were unnecessary restrictions being placed on the eligibility for a Letter of Priority Engagement (LOPE).

Agency's Response 11: This is a misinterpretation of the change to this section. The regulation does not discuss the benefits for residents specifically due to a Federally declared disaster, under the Uniform Relocation Act. The LOPE would be based on the termination of occupancy beyond the resident's control, such as the unavailability of the unit due to rehabilitation, which may be due to a disaster. Further, the proposed changes reduce restrictions on timing of LOPE requests. This effectively adds that they do not have to wait until the expiration of the declaration.

Issue 12: Several commenters pointed out that the change in §3560.205, regarding the notification of rent change, would better serve tenants to include “at least” 30 calendar days from the date of notification.

Agency's Response 12: The Agency agrees that this suggestion allows more ample notification, in some instances. The proposed revision will include “at least” before the 30 days from the date of notification.

Issue 13: Several commenters provided positive support for the clarification in RA eligibility requirements, for tenants or applicants with delinquent Agency unauthorized assistance repayment agreements. Several commenters discussed citizenship requirements under other sections of the regulation, not included in the proposed rule.

Agency's Response 13: The Agency acknowledges the commenters' support. The citizenship requirement is not under the purview of the published amendments. This amendment applies only to tenants with unauthorized RA who are delinquent on their repayment agreement. This would apply in cases where it is known that the tenant is delinquent directly with the Agency. The requested changes would require an additional CFR to be removed, since the existing CFR does not require citizenship requirements. We will be providing more guidance on implementation on future handbook updates.

Issue 14: Several commenters provided positive support for the update in the proposed rule regarding the optional use of the remaining obligation balances of RA units, identified in §3560.259(a)(2) and (3), for renewal purposes. However, some commenters were concerned that the ability to use "inactive" RA obligations will assist fewer residents (MFH tenants).

Agency's Response 14: The Agency acknowledges these concerns. The ability, however, to use "inactive" remaining RA obligations will assist more residents, rather than less residents. Further, the use of these "inactive" funds would not decrease the overall RA budget so in following years, new units of RA could be offered. By utilizing these funds, the Agency is protecting properties from payment shortfalls where the predicted amount of RA was misjudged. Furthermore, RA is funded through dollar amount and not by unit amount.

Issue 15: Several commenters stated opposition to the proposed change to § 3560.259, which clarifies that when any RA units have not been used for a 6-month period (for Section 515 properties) or 12 months (for Section 514 properties), they will be eligible for transfer. These commenters believed that this may reduce the total number of RA units and restrict eligible uses of RA. Additional concern regarded restricting the unused RA obligations to be used only for "renewal purposes". The inference is that this would reduce the number of RA units available for servicing or preservation.

Agency's Response 15: The Agency notes these concerns about the ability to use "inactive" RA obligations. This amendment will allow the Agency the flexibility to assist more residents, rather than fewer. Furthermore, the use of these "inactive" funds would not decrease the overall RA budget, so in following years new units of RA could be offered. By utilizing these funds, the Agency is protecting properties from payment shortfalls, where the predicted amount of RA was misjudged. Furthermore, RA is funded through dollar amount and not by unit amount. RA is not tied to a specific unit within the property; revolving vacancies would not affect whether there was unused RA over a 6-month period.

Issue 16: Some commenters suggested that the Agency include various project and management expenses, as allowable project expenses.

Agency's Response 16: The Agency acknowledges the need for consistency when appropriate; and acknowledges the need for clarity in eligible Section 514 and 515 property expenses. Property expenses are monitored by the Agency to ensure they are proper and reasonable; but as expenses increase, more income is needed, which results in rent increases and additional cost to rental assistance. Borrowers have often sought clarification on how expenses should be treated. Implementing this change will improve compliance, reduce unnecessary and unsupportable expenses, and result in stronger, more financially stable properties.

Issue 17: A commenter suggested non-ad valorem and special assessments need to be included as allowable project expenses as they are frequently included in a project's received tax notices.

Agency's Response 17: The Agency agrees with the comments and will include clarification to staff in the internal agency guidance to clarify that "expenses relating to controlling or reducing taxes" may include special assessments and service charges which are not based upon the value of the property and mileage.

Issue 18: One commenter requested a clarification of why asset management costs incurred by a non-profit entity must be prorated across all entities, and why this does not extend to all project owners. Other commenters requested more information on regulatory requirements not included in the proposed rule.

Agency's Response 18: The Agency appreciates the opportunity to address the issue on non-profit entities' asset management fee reimbursement of specifically identified costs. Specifically, for-profit entities are excluded due to the availability of financial means, such as the Return to Owner, to cover these costs.

The Agency acknowledges the additional questions on this section of the regulation, although not currently being revised. This will be taken under future consideration.

Issue 19: One commenter offered support for the requirement that needed capital improvements be completed within a reasonable time frame. The commenter requested guidance on what would be considered a "reasonable time frame," particularly emergency improvements.

Agency's Response 19: The Agency appreciates the support on this revision, and notes that "reasonable time frame" allows flexibility for the property manager, the borrower, and the property.

Issue 20: One commenter objected to a conversion of project loans from the Daily Interest Accrual System (DIAS) to the Predetermined Amortization Schedule System (PASS). The commenter added that many owners are anticipating their loan maturity under DIAS, would be materially harmed if they de facto have their loan terms extended by a slower pay-down or recasting of principal and interest payments.

Agency's Response 20: The Agency notes the commenter's concerns about borrowers under the DIAS loan terms. The Agency finds that no change is needed since the proposed rule only shortens the sentence to "loan servicing action".

Issue 21: One commenter noted that the proposed rule changes from “will” to “may” in §3560.656, which authorizes the Agency to offer an incentive to avoid prepayment. They noted that it would imply that the Agency will exercise discretion in offering incentives. The commenter believes that would be contrary to the current law.

Other commenters opposed the change, as they saw it as inconsistent with the mandatory obligation that Congress adopted for the express purpose of preserving and retaining to the maximum extent practicable. They commented that the Agency should abandon this change and continue to offer incentives to all owners seeking to prepay their loans.

Agency’s Response 21: The Agency is implementing section 502(c)(4)(B) of the Housing Act, which uses the term “may.” The Agency finds that this correction is necessary, to align regulations with the Housing Act.

III. Summary of Changes

To increase transparency, improve efficiency in managing portfolio assets, and ensure compliance with program requirements; RHS will implement the following updates to 7 CFR part 3560 for the Section 514 Farm Labor Direct Loan, Section 515 Mutli-family Housing Direct Loan, Section 516 Farm Labor Grant, and Section 521 Rental Assistance Program.

(1) Update language to §3560.259(d) regarding the optional use of the remaining obligation balances of units identified in §3560.259(a)(2) and (3) for renewal purposes.

(2) Update §3560.259(a)(4) to clarify that when any rental assistance units have not been used for a 6-month period (for Section 515 properties) or 12 months (for Section 514 properties) they will be eligible for transfer.

(3) The definitions of Domestic farm laborer, Management agreement, and Management fee will be revised to reflect requirements in the Consolidated Appropriations Act, 2018 (Pub. L. 115-141, March 23, 2018) permanently amending Section 514(f)(3)(A) of the Housing Act of

1949 (42 U.S.C. 1484(f)(3)(A)) that the FLH tenant eligibility includes “a person legally admitted to the United States and authorized to work in agriculture.”

(4) Adding a paragraph at §3560.65 to allow the Agency to establish an escrow account to collect and disperse funds. This will allow the Agency to establish agency-held escrows which historically was provided for in the loan documents but was not addressed in the regulation.

(5) In §3560.303(a)(1), the Agency will require that the annual project budget include anticipated expenditures on the project's long-term capital needs as specified in §3560.103(c) and will provide a metric for the Agency to determine current or future rent increase requests based on the Borrower's utilization of the reserve account. This will ensure that borrowers are utilizing project revenue for ongoing capital improvements needed to maintain compliance and reduced risk of the property.

(6) A change will be made to §3560.303(c) to add payables as a priority for budget expenditures. This will allow for the Agency to ensure that all payables are being paid from project revenues in a timely manner and not accrued, without agency consent, causing increased costs and penalties and adding risk.

(7) In §3560.303, the Agency will clarify what are allowable project expenses and provide for a comparable “reasonableness” test by the Agency. Generally, expenses charged to project operations for expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property.

(8) In §3560.303(b)(1)(vii), the Agency will add the requirements for a non-profit entity to pro-rate certain organizational reimbursable costs across all properties owned by that entity.

(9) In §3560.105(f)(10), the Agency will clarify that if an insurance deductible is met, there is no need to track with a replacement reserve account.

(10) The Agency has updated the wording of “State Director” to “Leadership Designee” to allow for future staff flexibility.

(11) Update §3560.152 by removing term “elderly units in mixed housing”.

(12) The Agency will revise §3560.154 to correct “sex” to “gender” and update policy on criminal activity for admissions.

(13) Update §3560.205 to include the notification of all household members of rent change effective at least 30 days from date of notification.

(14) Section 3560.252 will now include the Agency's housing voucher program to allow for the proper allowance of rental subsidies.

(15) In §3560.402 the Agency will clarify that any loan servicing action will require DIAS accounts to be converted to the current PASS system of accounting.

Executive Order 12866

The Office of Management and Budget (OMB) has designated this final rule as not significant under Executive Order 12866.

Executive Order 12988, Civil Justice Reform

This final rule has been reviewed under Executive Order 12988. In accordance with this rule: (1) Unless otherwise specifically provided, all State and local laws that conflict with this rule will be preempted; (2) no retroactive effect will be given to this rule except as specifically prescribed in the rule; and (3) administrative proceedings of the National Appeals Division of the Department of Agriculture (7 CFR part 11) must be exhausted before bringing suit in court that challenges action taken under this rule.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act (UMRA), Public Law 104-4, establishes requirements for Federal Agencies to assess the effects of their regulatory actions on State, local, and tribal Governments and on the private sector. Under section 202 of the UMRA, Federal Agencies generally must prepare a written statement, including cost-benefit analysis, for proposed and Final Rules with “Federal mandates” that may result in expenditures to State, local, or tribal Governments, in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires a Federal Agency to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective, or least burdensome alternative that achieves the objectives of the rule.

This final rule contains no Federal mandates (under the regulatory provisions of title II of the UMRA) for State, local, and tribal Governments or for the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

National Environmental Policy Act

In accordance with the National Environmental Policy Act of 1969, Public Law 91-190, this final rule has been reviewed in accordance with 7 CFR part 1970 (“Environmental Policies and Procedures”). The Agency has determined that i) this action meets the criteria established in 7 CFR 1970.53(f); ii) no extraordinary circumstances exist; and iii) the action is not “connected” to other actions with potentially significant impacts, is not considered a “cumulative action” and is not precluded by 40 CFR 1506.1. Therefore, the Agency has determined that the action does

not have a significant effect on the human environment, and therefore neither an Environmental Assessment nor an Environmental Impact Statement is required.

Executive Order 13132, Federalism

The policies contained in this rule do not have any substantial direct effect on States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. This rule does not impose substantial direct compliance costs on State and local governments; therefore, consultation with States is not required.

Regulatory Flexibility Act

The final rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601-612). The undersigned has determined and certified by signature on this document that this rule will not have a significant economic impact on a substantial number of small entities since this rulemaking action does not involve a new or expanded program nor does it require any more action on the part of a small business than required of a large entity.

Executive Order 12372, Intergovernmental Review of Federal Programs

These loans are subject to the provisions of Executive Order 12372, which require intergovernmental consultation with State and local officials. RHS conducts intergovernmental consultations for each loan in accordance with 2 CFR part 415, subpart C.

Executive Order 13175, Consultation and Coordination with Indian Tribal Governments

Executive Order 13175 imposes requirements on RHS in the development of regulatory policies that have tribal implications or preempt tribal laws. RHS has determined that the rule does not have a substantial direct effect on one or more Indian tribe(s) or on either the relationship or the distribution of powers and responsibilities between the Federal Government and Indian tribes. Thus, this rule is not subject to the requirements of Executive Order 13175. If tribal leaders are interested in consulting with RHS on this rule, they are encouraged to contact USDA's Office of Tribal Relations or RD's Native American Coordinator at: AIAN@usda.gov to request such a consultation.

Programs Affected

The programs affected by this regulation are listed in the Assistance Listing Catalog (formerly Catalog of Federal Domestic Assistance) under number 10.427—Rural Rental Assistance Payments.

Paperwork Reduction Act

The information collection requirements contained in this regulation have been approved by OMB and have been assigned OMB control number 0575-0189. This final rule contains no new reporting and recordkeeping requirements that would require approval under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35).

E-Government Act Compliance

RHS is committed to complying with the E-Government Act by promoting the use of the internet and other information technologies in order to provide increased opportunities for citizen access to Government information, services, and other purposes.

Non-Discrimination Statement

In accordance with Federal civil rights laws and U.S. Department of Agriculture (USDA) civil rights regulations and policies, the USDA, its Mission Areas, agencies, staff offices, employees, and institutions participating in or administering USDA programs are prohibited from discriminating based on race, color, national origin, religion, sex, gender identity (including gender expression), sexual orientation, disability, age, marital status, family/parental status, income derived from a public assistance program, political beliefs, or reprisal or retaliation for prior civil rights activity, in any program or activity conducted or funded by USDA (not all bases apply to all programs). Remedies and complaint filing deadlines vary by program or incident.

Program information may be made available in languages other than English. Persons with disabilities who require alternative means of communication to obtain program information (e.g., Braille, large print, audiotope, American Sign Language) should contact the responsible Mission Area, agency, or staff office; the USDA TARGET Center at (202) 720-2600 (voice and TTY); or the Federal Relay Service at (800) 877-8339.

To file a program discrimination complaint, a complainant should complete a Form AD-3027, USDA Program Discrimination Complaint Form, which can be obtained online at <https://www.ocio.usda.gov/document/ad-3027>, from any USDA office, by calling (866) 632-9992, or by writing a letter addressed to USDA. The letter must contain the complainant's name, address, telephone number, and a written description of the alleged discriminatory action in sufficient detail to inform the Assistant Secretary for Civil Rights (ASCR) about the nature and

date of an alleged civil rights violation. The completed AD-3027 form or letter must be submitted to USDA by:

(1) Mail: U.S. Department of Agriculture

Office of the Assistant Secretary for Civil Rights

1400 Independence Avenue, SW

Washington, D.C. 20250-9410; or

(2) Fax: (833) 256-1665 or (202) 690-7442; or

(3) Email: program.intake@usda.gov

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List of Subjects in 7 CFR Part 3560

Accounting, Administrative practice and procedure, Aged, Conflict of interest, Government property management, Grant programs-housing and community development, Insurance, Loan programs-agriculture, Loan programs-housing and community development, Low and moderate income housing, Migrant labor, Mortgages, Nonprofit organizations, Public housing, Rent subsidies, Reporting and recordkeeping requirements, Rural areas.

For the reasons set forth in the preamble, the Rural Housing Service amends 7 CFR part 3560 as follows:

PART 3560-DIRECT MULTI-FAMILY HOUSING LOANS AND GRANTS

1. The authority citation for part 3560 continues to read as follows:

Authority: 42 U.S.C. 1480.

Subpart A-General Provisions and Definitions

§3560.8 [Amended]

2. Amend §3560.8 by removing the words “State Director” and adding in their place “Leadership Designee” in the last sentence.

3. Amend §3560.11 as follows:

a. Remove the acronym “MFHMFH” wherever it appears in the section and adding “MFH” in its place; and

b. Revise the definitions of “Domestic farm laborer”, “Management agreement”, and “Management fee”.

The revisions read as follows:

§3560.11 Definitions.

* * * * *

Domestic farm laborer. A person who, consistent with the requirements in §3560.576(b)(2), receives a substantial portion of his or her income from farm labor employment (not self-employed) in the United States, Puerto Rico, or the Virgin Islands and either is a citizen of the United States or resides in the United States, Puerto Rico, or the Virgin Islands after being legally admitted for permanent residence, or a person legally admitted to the United States and authorized to work in agriculture. This definition may include the immediate family members residing with such a person.

* * * * *

Management agreement. A written agreement between a borrower and an identity-of-interest (IOI) management agent or independent fee management agent setting forth the management agent's responsibilities and fees for management services.

Management fee. The compensation provided to a management agent for services provided in accordance with an approved management certification, Form RD 3560-13, “Multi-Family Project Borrower's/Management Agent's Management Certification.”

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Subpart B-Direct Loan and Grant Origination

4. Amend §3560.65 by adding paragraph (d) to read as follows:

§3560.65 Reserve account.

* * * * *

(d) The agency may establish an escrow account for the collection and disbursement of reserve account funds.

§3560.72 [Amended]

5. Amend §3560.72 by removing the words “State Director” and adding in their place “Leadership Designee” in the second sentence of paragraph (b).

Subpart C-Borrower Management and Operations Responsibilities

6. Amend §3560.102 as follows:

- a. Revise paragraph (b);
- b. Remove the word “and” at the end of paragraph (g)(1)(ii);
- c. Remove “any of the above.” at the end of paragraph (g)(1)(iii) and adding “anyone listed in paragraphs (g)(1)(i) and (ii) of this section;” in its place;
- d. Add paragraph (g)(1)(iv); and
- e. Revise paragraphs (i) and (j).

The revisions and addition read as follows:

§3560.102 Housing project management.

* * * * *

(b) *Management plan.* Borrowers must develop and maintain a management plan for each housing project covered by their loan or grant. The management plan must establish the systems and procedures necessary to ensure that housing project operations comply with Agency requirements in this part. The management plan should describe whether administrative expenses are to be paid from management agent fees or project operations, including a task list of charges covered by the fee as outlined in paragraph (i)(3)(i)(A) of this section. The management plan must meet the standards set out in this part.

* * * * *

(g) * * *

(1) * * *

(iv) Any borrower's entity control, or interest held or possessed by a person's spouse, parent, child, grandchild, or sibling or other relation by blood or marriage is attributed to that person for the determination under this paragraph (g)(1).

* * * * *

(i) *Management fees.* Management fees will be an allowable expense to be paid from the housing project's general operating account only if the fee is approved by the Agency as a reasonable cost to the housing project and documented on the management certification.

Management fees must be developed in accordance with the following:

(1) The management fee may compensate the management entity for the following costs and services:

- (i) Supervision by the management agent and its staff (time, knowledge, and expertise) of overall operations and capital improvements of the site.
- (ii) Hiring, supervision, and termination of on-site staff.
- (iii) General maintenance of project books and records (general ledger, accounts payable and receivable, payroll, etc.). Preparation and distribution of payroll for all on-site employees, including the costs of preparing and submitting all appropriate tax reports and deposits, unemployment and workers' compensation reports, and other IRS- or state-required reports.
- (iv) In-house training provided to on-site staff by the management company.
- (v) Preparation and submission of proposed annual budgets and negotiation of approval with the Agency.
- (vi) Preparation and distribution of the Agency forms and routine financial reports to borrowers.
- (vii) Preparation and distribution of required year-end reports to the Agency.
- (viii) Preparation of requests for reserve withdrawals, rent increases, or other required adjustments.
- (ix) Arranging for preparation by outside contractors of utility allowance analysis.
- (x) Preparation and implementation of Affirmative Fair Housing Marketing Plans as well as general marketing plans and efforts.
- (xi) Review of tenant certifications and submission of monthly rental assistance requests, and overage. Submission of payments where required.
- (xii) Preparation, approval, and distribution of operating disbursements; oversight of project receipts; and reconciliation of deposits.
- (xiii) Overhead of management agent, including:

(A) Establish, maintain, and control an accounting system sufficient to carry out accounting supervision responsibilities.

(B) Maintain agent office arrangements, staff, equipment, furniture, and services necessary to communicate effectively with the properties, to include consultation and support to site-staff, the Agency and with the borrowers.

(C) Postage expenses unrelated to site operation.

(D) Expense of telephone and facsimile communication, unrelated to site operations.

(E) Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.) directly related to protection of the funds and records of the borrower. Insurance coverage for agent's office and operations (Property, Auto, Liability, Errors and Omissions, Casualty, Workers Compensation, etc.).

(F) Central office staff training and ongoing certifications.

(G) Maintenance of all required profession and business licenses and permits. (This does not include project site office permits or licenses.)

(H) Travel of agent staff to the properties for on-site inspection, training, or supervision activities.

(I) Agent bookkeeping for their own business.

(xiv) Attendance at meetings (including travel) with tenants, owners, and the Agency or other governmental agency.

(xv) Development, preparation, and revision of management plans, agreements, and management certifications.

(xvi) Directing the investment of project funds into required accounts.

(xvii) Maintenance of bank accounts and monthly reconciliations.

(xviii) Preparation, request for, and disbursement of borrower's initial operating capital (for new projects) as well as administration of annual owner's return on investment.

(xix) Account maintenance, settlement, and disbursement of security deposits.

(xx) Working with auditors for initial Agency annual financial reports.

(xxi) Storage of records, to include electronic records, and adherence to records retention requirements.

(xxii) Assist on-site staff with tenant relations and problems. Provide assistance to on-site staff in severe actions (eviction, death, insurance loss, etc.).

(xxiii) Oversight of general and preventive maintenance procedures and policies.

(xxiv) Development and oversight of asset replacement plans.

(xxv) Oversight of preparation of section 504 reviews, development of plans, and implementation of improvements necessary to comply with plans and section 504 requirements.

(2) Management fees may consist of a base per occupied revenue producing unit fee and add-on fees for specific housing project characteristics. Management entities may be eligible to receive the full base per occupied unit fee for any month or part of a month during which the unit is occupied.

(i) Periodically, the Agency will develop a range of base per occupied unit fees that will be paid in each state. The Agency will develop the fees based on a review of housing industry data. The final base for occupied unit fees for each state will be made available to all borrowers.

(ii) Periodically, the Agency will develop the amount and qualifications to receive add-on fees. The final set of qualifications will be made available to all borrowers.

(3) Management plans and agreements must describe if administrative expenses are to be paid from the management fee or paid for as a project cost.

(i) A task list should be used to identify which services are included in the management fee, which services are included in project operations, and which are pro-rated along with the methodology used to pro-rating of expenses between management agent fees and project operations. Some property responsibilities are completed at the property and some offsite. Agent responsibilities may be performed at the property, the management office, or at some other location.

(ii) Disputes may arise as to who performs certain services. The management plan and job descriptions should normally provide sufficient clarity to avoid or resolve any such disputes; however, sometimes clarifications and supporting materials may be required to resolve disputes. The decision must be made based on the most complete evaluation of the facts presented.

(j) *Management certification.* (1) As a condition of approval of project management, including borrowers who self-manage, borrower and management agents must execute an Agency-approved certification certifying that:

(i) Borrowers and management agent agree to operate the housing project in accordance with the management plan;

(ii) Borrowers and the management agent will comply with Agency requirements, loan or grant agreements, applicable local, State, Tribal, and Federal laws and ordinances, and contract obligations, will certify that no payments have been made to anyone in return for awarding the management contract to the management agent, and will agree that such payments will not be made in the future;

(iii) Borrowers and the management agent will comply with Agency notices or other policy directives that relate to the management of the housing project;

(iv) Management agreement between the borrower and management agent complies with the requirements of this section;

(v) Allowable management fees are assessed and paid out of the housing projects' general operating account. Borrowers and management agents will comply with Agency requirements regarding management fees as specified in paragraph (i) of this section, and allocation of management costs between the management fee and the housing project financial accounts specified in §3560.302(c)(3);

(vi) The borrower and the management agent will not purchase goods and services from entities that have an identity-of-interest (IOI) with the borrower or the management agent until the IOI relationship has been disclosed to the Agency according to paragraph (g) of this section, not denied by the Agency under paragraph (d)(3) of this section, and it has been determined that the costs are as low as or lower than arms-length, open-market purchases; and

(vii) The borrower and the management agent agree that all records related to the housing project are the property of the housing project and that the Agency, OIG, or GAO may inspect the housing records and the records of the borrower, management agent, and suppliers of goods and services having an IOI with the borrower or with a management agent acting as an agent of the borrower upon demand.

(2) A certification will be executed each time new management is proposed and/or a management agreement is executed or renewed. Any amendment to a management certification must be approved by the Agency and the borrower.

* * * * *

7. Amend §3560.104 by revising paragraph (b)(1) to read as follows:

§3560.104 Fair housing.

* * * * *

(b) * * *

(1) Borrowers with housing projects that have five or more rental units must prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) as defined in 24 CFR part 200, subpart M.

* * * * *

8. Amend §3560.105 by revising paragraphs (c)(4) and (f)(10) to read as follows:

§3560.105 Insurance and taxes.

* * * * *

(c) * * *

(4) If the best insurance policy a borrower can obtain at the time the borrower receives the loan or grant contains a loss deductible clause greater than that allowed by paragraph (f)(9) of this section, the insurance policy and an explanation of the reasons why more adequate insurance is not available must be submitted to the Agency prior to loan or grant approval.

* * * * *

(f) * * *

(10) Deductible amounts (excluding flood, windstorm, earthquake and sinkhole insurance, or mine subsidence insurance) must be accounted for in the replacement reserve account, unless the deductible does not exceed the maximum deductible allowable as indicated in paragraph (f)(9)(i) of this section. Borrowers who wish to increase the deductible amount must deposit an additional amount to the reserve account equal to the difference between the Agency's maximum deductible and the requested new deductible. The Borrower will be required to maintain this additional amount so long as the higher deductible is in force.

* * * * *

Subpart D-Multi Family Housing Occupancy

9. Amend §3560.152 by revising paragraphs (c) heading and introductory text, (c)(1) introductory text, and (e)(2)(iv) to read as follows:

§3560.152 Tenant eligibility.

* * * * *

(c) *Requirements for elderly housing, congregate housing, and group homes.* In addition to the requirements of paragraph (a) of this section, the following occupancy requirements apply to elderly housing and congregate housing or group homes:

(1) For elderly housing and congregate housing, the following provisions apply:

* * * * *

(e) * * *

(2) * * *

(iv) Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents, borrowers who fail to submit annual or updated tenant certification forms within the time period specified in paragraph (e)(2)(iii) of this section will be charged overage, as specified in §3560.203(c) and lost rental assistance. Unauthorized assistance, if any, will be handled in accordance with subpart O of this part.

* * * * *

10. Amend §3560.154 by revising paragraphs (a)(9) introductory text and (j) to read as follows:

§3560.154 Tenant selection.

(a) * * *

(9) Race, ethnicity, and gender designation. The following disclosure notice shall be used:

* * * * *

(j) *Criminal activity*. Borrowers will deny admission for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.854, 5.855, 5.856, and 5.857.

11. Amend §3560.156 as follows:

- a. Revise paragraph (c)(1);
- b. Remove “and” at the end of paragraph (c)(6)(iii);
- c. Remove the period at the end of paragraph (c)(6)(iv) and add “; and” in its place;
- d. Add paragraph (c)(6)(v); and
- e. Revise paragraphs (c)(15) and (16).

The revisions and addition read as follows:

§3560.156 Lease requirements.

* * * * *

(c) * * *

(1) Leases for tenants who hold a Letter of Priority Entitlement (LOPE) issued according to §3560.660(c) and are temporarily occupying a unit for which they are not eligible must include a clause establishing the tenant's responsibility to move when a suitable unit becomes available in the housing project.

* * * * *

(6) * * *

(v) The Violence Against Women Reauthorization Act of 2013 and any amendments thereto.

* * * * *

(15) Leases, including renewals, must include the following language:

“It is understood that the use, or possession, manufacture, sale, or distribution of an illegal controlled substance (as defined by local, State, Tribal or Federal law) while in or on any part of this apartment complex premises or cooperative is an illegal act. It is further understood that such action is a material lease violation. Such violations (hereafter called a “drug violation”) may be evidenced upon the admission to or conviction of the use, possession, manufacture, sale, or distribution of a controlled substance (as defined by local, State, Tribal, or Federal law) in any local, State, Tribal or Federal court.

The landlord may require any lessee or other adult member of the tenant household occupying the unit (or other adult or non-adult person outside the tenant household who is using the unit) who commits a drug violation to vacate the leased unit permanently, within timeframes set by the landlord, and not thereafter to enter upon the landlord's premises or the lessee's unit without the landlord's prior consent as a condition for continued occupancy by the remaining members of the tenant's household. The landlord may deny consent for entry unless the person agrees to not commit a drug violation in the future and is either actively participating in a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program.

The landlord may require any lessee to show evidence that any non-adult member of the tenant household occupying the unit, who committed a drug violation,

agrees not to commit a drug violation in the future, and to show evidence that the person is either actively seeking or receiving assistance through a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program within timeframes specified by the landlord as a condition for continued occupancy in the unit.

Should a further drug violation be committed by any non-adult person occupying the unit the landlord may require the person to be severed from tenancy as a condition for continued occupancy by the lessee.

If a person vacating the unit, as a result of the above policies, is one of the lessees, the person shall be severed from the tenancy and the lease shall continue among any other remaining lessees and the landlord. The landlord may also, at the option of the landlord, permit another adult member of the household to be a lessee.

Should any of the above provisions governing a drug violation be found to violate any of the laws of the land the remaining enforceable provisions shall remain in effect. The provisions set out above do not supplant any rights of tenants afforded by law.”

(16) Leases for rental units accessible to individuals with disabilities occupied by those not needing the accessibility features must establish the tenant's responsibility to move to another unit within 30-days of written notification that the unit is needed by an eligible qualified person with disabilities who requires the accessibility features of the unit. Additionally, the lease clause must ensure that the household may remain in the rental unit with accessibility features until an appropriately sized vacant unit within the project becomes available and then must move or vacate within 30 days of notification from borrower.

* * * * *

12. Amend §3560.158 by revising paragraph (d)(3) introductory text to read as follows:

§3560.158 Changes in tenant eligibility.

* * * * *

(d) * * *

(3) After the death of a tenant or co-tenant in elderly housing, the surviving members of the household, regardless of age but taking into consideration the conditions of paragraph (d)(1) of this section, may remain in the rental unit in which they were residing at the time of the tenant's or co-tenant's death, even if the household is over housed according to the housing project's occupancy rules except as follows:

* * * * *

13. Amend §3560.159 by revising paragraph (c) to read as follows:

§3560.159 Termination of occupancy.

* * * * *

(c) *Other terminations.* Should occupancy be terminated due to conditions which are beyond the control of the tenant, such as a condition related to required repair or rehabilitation of the building, or a natural disaster, and prior to expiration of the disaster declaration, the tenants who are affected by such a circumstance are entitled to benefits under the Uniform Relocation Act and may request a Letter of Priority Entitlement (LOPE) from the Agency. If tenants need additional time to secure replacement housing, the Agency may, at the tenant's request, extend the LOPE entitlement period.

* * * * *

Subpart E-Rents

14. Amend §3560.205 by revising paragraph (e) to read as follows:

§3560.205 Rent and utility allowance changes.

* * * * *

(e) *Approval.* If the Agency approves a rent or utility allowance increase request on which the comments were solicited, tenants or members receiving notice of a proposed rent or utility allowance change in accordance with paragraph (d)(2) of this section shall be notified of the rent or utility allowance change to be effective, at least 30 calendar days from the date of the notification.

* * * * *

15. Amend §3560.207 by revising paragraph (b) to read as follows:

§3560.207 Annual adjustment factors for Section 8 units.

* * * * *

(b) *Establishing rents in housing with HUD rent assistance.* Borrowers will set basic, note, and HUD contract rents for housing receiving HUD project-based Section 8 assistance, as specified in §3560.202(c).

* * * * *

Subpart F-Rental Subsidies

16. Amend §3560.252 as follows:

- a. Redesignate paragraphs (b)(2) through (4) as paragraphs (b)(3) through (5), respectively, and add new paragraph (b)(2); and
- b. Revise paragraph (c)(2) introductory text.

The addition and revisions read as follows:

§3560.252 Authorized rental subsidies.

* * * * *

(b) * * *

(2) Agency housing vouchers;

* * * * *

(c) * * *

(2) Tenants with subsidies from sources other than the Agency may be eligible for Agency rental assistance if all the following conditions are met.

* * * * *

17. Amend §3560.254 by revising paragraphs (c)(1), (2), (4), and (5) and adding paragraph (c)(6) to read as follows:

§3560.254 Eligibility for rental assistance.

* * * * *

(c) * * *

(1) With very low- or low-incomes who are eligible to live in MFH;

(2) Whose net tenant contribution to rent determined in accordance with §3560.203(a)(1) is less than the basic rent for the unit;

* * * * *

(4) Who meet the occupancy rules/policies established by the borrower in accordance with §3560.155(e);

(5) Who have a signed, unexpired tenant certification form on file with the borrower; and

(6) Who is not delinquent on any Agency unauthorized assistance repayment agreements.

18. Revise §3560.258 to read as follows:

§3560.258 Terms of agreement.

(a) *Term of agreement.* Rental assistance agreements will have a term of the later of 12 months from the first disbursement of the obligation or when funds under the agreement are exhausted.

(b) *Replacing expiring obligations.* Rental assistance agreements may be renewed in accordance with §3560.255(a)(1).

19. Amend §3560.259 by revising paragraphs (a)(3) and (4) and adding paragraph (d) to read as follows:

§3560.259 Transferring rental assistance.

(a) * * *

(3) After a liquidation, prepayment, or natural maturity;

(4) To the extent permitted by law, when any rental assistance units have not been used for a 6-month period (Section 515) or a 12-month period (Section 514 or 516); or

* * * * *

(d) *Agency use of obligation balances.* In lieu of transferring rental assistance units, the Agency may elect to utilize the remaining obligation balances of units identified in paragraphs (a)(2) and (3) of this section for renewal purposes.

Subpart G-Financial Management

20. Amend §3560.302 by revising paragraphs (c)(3)(ii) and (iii) and (c)(5)(i), (ii), and (iv) to read as follows:

§3560.302 Accounting, bookkeeping, budgeting, and financial management systems.

* * * * *

(c) * * *

(3) * * *

(ii) Real estate tax and insurance account (if not part of the general operating account or unless escrowed by the Agency);

(iii) Reserve account (unless escrowed by the Agency in accordance with §3560.65);

* * * * *

(5) * * *

(i) All housing project funds must be held only in financial institution accounts insured by an agency of the Federal Government or held in securities meeting the conditions in this subpart.

(ii) Funds maintained in an institution may not exceed the limit established for Federal deposit insurance. Funds exceeding the Federally insured limit under a Tax ID Number must be moved to a different qualified banking institution that will ensure the funds unless the current financial institution provides additional surety such as a collateral pledge that may already be in place.

* * * * *

(iv) All funds received and held in any account, except the tenant security deposit, membership fee, and patron capital accounts, are considered assets of the property and must be held in trust by the borrower for the loan obligations until used and serve as security, through transfers or assumptions for the Agency loan or grant until all outstanding balances are satisfied.

* * * * *

21. Revise §3560.303 to read as follows:

§3560.303 Housing project budgets.

(a) *General requirements.* (1) Using an Agency-approved format, borrowers must submit to the Agency for approval a proposed annual housing project budget prior to the start of the housing project's fiscal year. The capital budget section of the annual project budget must include anticipated expenditures on the project's long-term capital needs as specified in §3560.103(c) and will assist the Agency on utilization of the reserve account for current or future rent increase requests.

(2) Budget projections regarding income, expenses, vacancies, and contingencies must be realistic given the housing project's history, current circumstances, and market conditions.

(3) Borrowers must document that the operating expenses included in the budget accurately reflect reasonable and necessary costs to operate the housing project in a manner consistent with the objectives of the loan and in accordance with the applicable Agency requirements in this part.

(4) Borrower must submit supporting documentation to justify housing project utility allowances.

(5) Upon Agency request, borrowers must submit any additional documentation necessary to establish that applicable Agency requirements in this part have been met.

(b) *Allowable and unallowable project expenses.* Expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes.

(1) *Allowable expenses.* Allowable expenses include those expenses that are directly attributable to housing project operations and are necessary to carry out successful operations.

(i) Housing project expenses must not duplicate expenses included in the management fee as defined in §3560.102(i).

(ii) Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. This includes managers, maintenance staff, and temporary help including their:

(A) Gross salary;

(B) Employer Federal Insurance Contributions Act (FICA) contribution;

(C) Federal unemployment tax;

(D) State unemployment tax;

(E) Workers compensation insurance;

(F) Health insurance premiums;

(G) Cost of fidelity or comparable insurance;

(H) Leasing, performance incentive, or annual bonuses that are clearly provided for by the site manager salary contract;

(I) Direct costs of travel to off-site locations by on-site staff for property business or training; and/or

(J) Retirement benefits.

(iii) Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, and the preparation of all legal documents.

(iv) All outside account and auditing fees, if required by the Agency, directly related to the preparation of the annual audit, partnership tax returns, and 401-K's, as well as other outside reports and year-end reports to the Agency, or other governmental agency.

(v) All repair and maintenance costs for the project including:

(A) Maintenance staffing costs and related expenses.

(B) Maintenance supplies.

(C) Contract repairs to the projects (e.g., heating and air conditioning, painting, roofing).

(D) Make ready expenses including painting and repairs, flooring replacement, and appliance replacement as well as drapery or mini-blind replacement. (Turnover maintenance.)

(E) Preventive maintenance expenses including occupied unit repairs and maintenance as well as common area systems repairs and maintenance.

(F) Snow removal.

(G) Elevator repairs and maintenance contracts.

(H) Section 504 and other Fair Housing compliance modifications and maintenance.

(I) Landscaping maintenance, replacements, and seasonal plantings.

(J) Pest control services.

(K) Other related maintenance expenses.

(vi) All operational costs related to the project including:

(A) The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.

(B) Photocopying or printing expense related to actual production of project brochures, marketing pieces, forms, reports, notices, and newsletters are allowable project expenses no

matter what location or point of origin the work is performed including outsourcing the work to a professional printer.

(C) All bank charges related to the property including purchases of supplies (e.g., checks, deposit slips, returned check fees, service fees).

(D) Costs of site-based telephone including initial installation, basic services, directory listings, and long-distances charges.

(E) All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, social media, radio, cable TV, and telephone books.

(F) Postage expense to mail out rental applications, third-party (asset income and adjustments to income) verifications, application processing correspondence (acceptance or denial letters), mailing project invoice payments, required correspondence, report submittals to various regulatory authorities for the managed property are allowable project expenses no matter what location or point of origin the mail is generated.

(G) State taxes and other mandated Tribal, State, or local fees as well as other relevant expenses required for operation of the property by a third-party governmental unit. Costs of continuation financing statements and site license and permit costs.

(H) Expenses related to site utilities.

(I) Site office furniture and equipment including site-based computer and copiers. Service agreements and warranties for copiers, telephone systems and computers are also included (if approved by the Agency).

(J) Real estate taxes (personal tangible property and real property taxes) and expenses related to controlling or reducing taxes.

(K) All costs of insurance including property liability and casualty as well as fidelity or crime and dishonesty coverage for on-site employees and the owners.

(L) All bookkeeping supplies and recordkeeping items related to costs of collecting rents on-site.

(M) All office supplies and copies related to costs of preparing and maintaining tenant files and processing tenant certifications to include electronic storage.

(N) Public relations expense relative to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. Chamber of Commerce dues, contributions to local charity events, and sponsorship of tenant activities, are examples.

(O) Tax credit compliance monitoring fees imposed by Housing Finance Authorities (HFAs).

(P) All insurance deductibles as well as adjuster expenses.

(Q) Professional service contracts (audits, owner-certified submissions in accordance with §3560.308(a)(2), tax returns, energy audits, utility allowances, architectural, construction, rehabilitation and inspection contracts, capital needs assessments (CNA), etc.).

(R) Association dues to be paid by the project should be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ratio, a reasonable expense may be billed to the project.

(S) Legal fees if found not guilty of civil lawsuits, commercially reasonable legal expenses and costs for defending or settling lawsuits.

(vii) With prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to reimburse actual and typical asset management expenses directly attributable to ownership responsibilities. Such expenses may include:

(A) Errors and omissions insurance policy for the Board of Directors. The cost must be prorated if the policy covers multiple Agency housing properties.

(B) Board of Directors review and approval of proposed Agency's annual operating budgets, including proposed repair and replacement outlays and accruals. The cost must be prorated if the policy covers multiple Agency housing properties.

(C) Board of Directors review and approval of capital expenditures, financial statements, and consideration of any management comments noted. The cost must be prorated if the policy covers multiple Agency housing properties.

(D) The cost must be prorated if the policy covers multiple Agency housing properties.

(viii) Agency approved third party debt service for the project.

(2) *Unallowable expenses*. Housing project funds may not be used for any of the following:

(i) Equity skimming as defined in 42 U.S.C. 543(a);

(ii) Purposes unrelated to the housing project;

(iii) Reimbursement of inaccurate or false claims;

(iv) Court ordered settlement agreements, court ordered decrees, legal fees, or other costs that result from the filing of civil rights complaints or legal action alleging the borrower, or a representative of the borrower, has committed a civil rights violation. It is inappropriate to charge for legal services to represent any interest other than the borrower's interest (i.e.,

representing a general partner or limited partner to defend their individual owner interest is not allowable);

(v) Fines, penalties, and legal fees where the borrower or a borrower's representative has been found guilty of violating laws, including, but not limited to, civil rights, and building codes. Charging for payment of penalties including opposition legal fees resulting from an award finding improper actions on the part of the owner or management agent is generally an inappropriate project expense. The party responsible generally pays such expenses for violating the standards or by their insurance carriers;

(vi) Association dues unless related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project;

(vii) Pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract;

(viii) Billing for parties or gifts to management agent staff;

(ix) Billing for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office;

(x) Billing the project for computer hardware, some software, and internal connections that are beyond the scope and size reasonably needed for the services supplied (i.e., purchasing equipment or software for use by a site manager that is clearly beyond that needed to support project operations). Note that computer learning center activities benefiting tenants are not covered in this prohibition; or

(xi) Costs of tenant services.

(c) *Priorities*. The priority order of planned and actual budget expenditures will be:

- (1) Senior position lienholder, if any;
- (2) Operating and maintenance expenses, including taxes and insurance;
- (3) Agency debt payments;
- (4) Reserve account requirements;
- (5) All accounts payable;
- (6) Other authorized expenditures; and
- (7) Return on owner investment.

(d) *Determining if expenses are reasonable.* Generally, expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes. If such value is not apparent, the service or expense should be examined.

(1) Administrative expenses for project operations exceeding 23 percent, or those typical for the area, of gross potential basic rents and revenues (i.e., referred to as gross potential rents in industry publications) highlight a need for closer review for unnecessary expenditures. Budget approval is required, and project resources may not always permit an otherwise allowable expense to be incurred if it is not fiscally prudent in the market.

(2) Excessive administrative expenses can result in inadequate funds to meet other essential project needs, including expenditures for repair and maintenance needed to keep the project in sound physical condition. Actions that are improper or not fiscally prudent may warrant budget denial and/or a demand for recovery action.

(e) *Agency review and approval.* (1) The Agency will only approve housing project budgets that meet the requirements of paragraphs (a) through (d) of this section.

(2) If no rent change is requested, borrowers must submit budget documents for Agency approval 60 calendar days prior to the start of the housing project's fiscal year. The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a) through (d) of this section. The borrower will have 10 days to submit the additional material.

(3) If a rent change is requested, the borrower must submit budget documents to the Agency and notify tenants of the requested rent change at least 90 calendar days prior to the start of the housing project's fiscal year.

(i) The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a) through (d) of this section, or if the rent and utility allowance request has been denied in accordance with §3560.205(f). The borrower will have 10 days to submit the additional material to address any issues raised by the Agency.

(ii) The rent change is not approved until the Agency issues a written approval. If there is no response from the Agency within the 30-day period, the rent change is considered automatic. The following budgets are not eligible for automatic approval:

(A) Budgets with rent increases above \$25 per unit; and

(B) Budgets that are submitted late or that miss other deadlines set by the Agency.

(4) If the Agency denies the budget approval, the Agency will notify the borrower in writing.

(5) If budget approval is denied, the borrower shall continue to operate the housing project based on the most recently approved budget.

22. Amend §3560.306 as follows:

a. Revise paragraphs (a), (b), (d), and (e)(2);

b. Redesignate paragraphs (g)(2) through (5) as paragraphs (g)(3) through (6), respectively, and add new paragraph (g)(2); and

c. Redesignate paragraph (j)(2) as paragraph (j)(3) and add new paragraph (j)(2).

The revisions and additions read as follows:

§3560.306 Reserve account.

(a) *Purpose.* To meet the major capital expense needs of a housing project, borrowers must establish and maintain a reserve account, unless escrowed by the Agency.

(b) *Financial management of the reserve account.* Unless otherwise approved by the Agency, borrower management of the reserve account is subject to the requirements of 7 CFR part 1902, subpart A, regarding supervised bank accounts.

* * * * *

(d) *Transfer of surplus general operating account funds.* (1) The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables and priorities, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, include the amount that should be escrowed by year end and subtract such tax and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

(2) If a housing project's general operating account has surplus funds at the end of the housing project's fiscal year as defined in paragraph (d)(1) of this section, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year. At the end of the borrower's fiscal year, if the borrower is required to

transfer surplus funds from the general operating account to the reserve account, the transfer does not change the future required contributions to the reserve account.

(e) * * *

(2) Reserve accounts must be supervised accounts that require the Agency to approve all withdrawals; except, this requirement is not applicable when loan funds guaranteed by the Section 538 GRRH program are used for the construction and/or rehabilitation of a direct MFH loan project. Direct MFH loan borrowers, who are exempted from the supervised account requirement, as described in this section, must follow Section 538 GRRH program regulatory requirements pertaining to reserve accounts. In all cases, Section 538 lenders must get prior written approval from the Agency before reserve account funds involving a direct MFH loan project can be disbursed to the borrower.

* * * * *

(g) * * *

(2) Borrowers should include any needed capital improvements based on the needs identified in an Agency approved Capital Needs Assessment (if obtained) are completed within a reasonable timeframe.

* * * * *

(j) * * *

(2) The Agency will allow for an annual adjustment to increase reserve account funding levels by Operating Cost Adjustment Factor (OCAF) as published by HUD annually. This will require a modification to the Loan agreement and the increase documented with budget submission as outlined in §3560.303.

* * * * *

Subpart I-Servicing

23. Amend §3560.402 by revising paragraph (b) to read as follows:

§3560.402 Loan payment processing.

* * * * *

(b) *Required conversion to PASS.* Borrowers with Daily Interest Accrual System (DIAS) accounts must convert to PASS with any loan servicing action.

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Subpart L-Off Farm Labor Housing

§3560.576 [Amended]

24. Amend §3560.576 by removing the words “State Director's” and adding in their place “MFH Leadership Designee's” in paragraph (e).

Subpart N-Housing Preservation

§3560.656 [Amended]

25. Amend §3560.656 by removing the word “will” and replacing it with “may” in paragraph (a) introductory text.

Joaquin Altoro,

Administrator,

Rural Housing Service.

